Vendor Centric

RETHINKING VENDORS 2.0

How to drive more value and less risk
from your vendor relationships.

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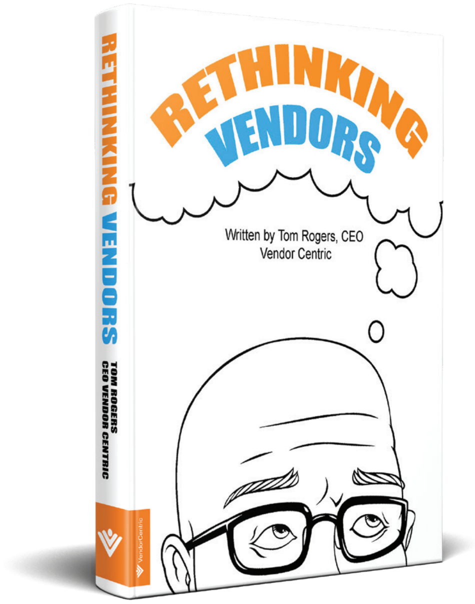
About Rethinking Vendors 2.0

When we wrote the original Rethinking Vendors (1.0) back in 2011, we shared our core philosophy about companies and their vendors. Namely, that companies are missing a tremendous opportunity for growth, efficiency and innovation when they view their vendors as costs rather than strategic resources.



At Vendor Centric we believe that when organizations surround themselves with the right vendors, and establish the necessary systems and culture to support those relationships, they realize operational and competitive advantages that they simply can't achieve on their own.

Fast forward to today, and we feel as strongly about this as ever before. Reliance on vendors and other types of third parties has never been more important, as globalization and cloud technologies continue to grow and relationships become deeper and more complex. As a result, vendor management is evolving from an ad hoc, back-office function to a key part of business operations with dedicated resources and increasing visibility in the board room.

So, what are the key factors that have been driving this change? And what are companies actually doing to drive more value, and less risk, from their vendor relationships?

Rethinking Vendors 2.0 dives into both of these questions, and provides you a clear path for actions you can take to drive more value from your vendor relationships too.

The Value of Great Vendors Hasn't Changed

Rethinking Vendors 1.0 made a case that most companies are missing out on the untapped value they can get from great vendor relationships. Vendors can include any supplier, contractor, consultant or other third party who provides products or services to your company. The benefits they provide include:

- **Knowledge.** They offer strategic ideas and tactical insights on how to plan, grow, manage risks and streamline operations.
- **Skills.** They provide technical and industry-specific skills like legal, marketing, technology (and even vendor management) that you may not have on staff or that you need for a particular project or initiative.
- **Experience.** They bring best practices they've learned from working on many projects across multiple companies and industries.
- **Scalability.** They give you a way to grow (or shrink) in a way that limits your investment and risk, and provide you with people, space, technology and other resources crucial to operations.
- **Distribution.** They enable you to extend your business and reach new markets by leveraging proven, established distribution channels.
- **Cost Efficiency.** They give you the ability to operate faster and cheaper, and turn fixed costs into variable costs.

The very best vendors become a strategic asset, a partner in execution, and an important member of the extended workforce.

The value of working with great vendors hasn't changed. But relationships have grown more complex – and more risky – due to a variety of factors including:

- Services, technology and data are being bundled into comprehensive, outsourced solutions with a single vendor.
- Sensitive data is being shared across your entire vendor ecosystem, oftentimes flowing down to your vendor's vendors (defined as "Nth Parties".)
- Advances in technology and distribution make it easier than ever to work with vendors around the world, creating a unique set of opportunities and challenges.

Risk Has Taken Center Stage

In the United States, vendor risk management (also referred to as third-party risk management) started to really come into focus in 2008 when the FDIC issued Financial Institution Letter 44-2008 (FIL-44-2008): Guidance for Managing Third-Party Risk. The guidance was an inflection point for vendor management, as it was based on employing a risk-based approach to managing vendors and other third parties. It also established several fundamentals of third-party risk management such as:

- Performing risk assessments to understand inherent risks of new relationships;
- Conducting risk-based due diligence prior to contracting to evaluate a vendor's controls and determine what residual risks remain;
- Following contracting standards to ensure proper risk transfer in legal agreements; and
- Performing an appropriate level of ongoing oversight to optimize performance and manage changing risks over the course of the relationship.

Other regulators to the financial services industry like OCC, NCUA, and FHFA followed the FDIC and issued their own third-party management regulations. In healthcare, the Health Information Technology for Economic and Clinical Health Act (HITECH) was introduced which extended HIPAA rules to third-party "Business Associates." And in the municipality and nonprofit sectors, the Office of Management and Budget issued the Uniform Guidance which, among other things, required that recipients of federal funding perform risk assessments and ongoing monitoring of their third-party "Subrecipients."

States have also come out with regulations focusing on third parties. Some of these newer federal and state regulations expanded upon FDIC fundamentals to introduce other important tenets of vendor risk management including the need for:

- board and senior management accountability,
- cybersecurity standards,
- termination standards,
- periodic program reviews, and
- compliance attestations.

While the regulations came out at different times, and targeted different industries, they all had one thing in common: the requirement to formalize a vendor management function that takes a risk-first approach to managing vendors and other third parties.

Despite the fact that regulations have driven this risk-first approach, this is not about compliance. This is about risk management. And, in our opinion, it's an approach every company needs to follow regardless of what the regulations say.

So, which types of risks do you need to manage?

That's a tricky question because every vendor (and every company) is different. Taking a risk-based approach means you need to look to your own environment and risk appetite, along with the nature and complexity of each vendor relationship, to hone in on the risks specific to you and each third party.

With that said, there are six key, overarching categories of risk that you should always consider when working with third parties.

6 Key Categories of Vendor Risks

1. **Reputational Risk.** Risk of your organization receiving negative public opinion due to problems with, or failure of, a vendor.
2. **Strategic Risk.** Risk arising from your inability to implement strategies or strategic initiatives due to vendor advice/failure.
3. **Operational Risk.** Risk of disruption to operations due to the failure in a vendor's processes, people or systems.
4. **Transactional Risk.** Risk of financial loss or damage to credit due to your inability to deliver important services, or transact business, due to problems (or fraud) created by a vendor.
5. **Compliance Risk.** Risk related to your violation of laws, policies, or regulations due to something the vendor does (or doesn't do).
6. **Information Risk.** Risk related to the exposure of non-public information (yours and your customers) due to breach or some other fault of a vendor.

While risk management may be taking center stage, the basics of vendor management remain the same. You still need to manage performance and costs, along with risk and compliance, to ensure you're getting the most value – and least risk – from your vendor relationships.

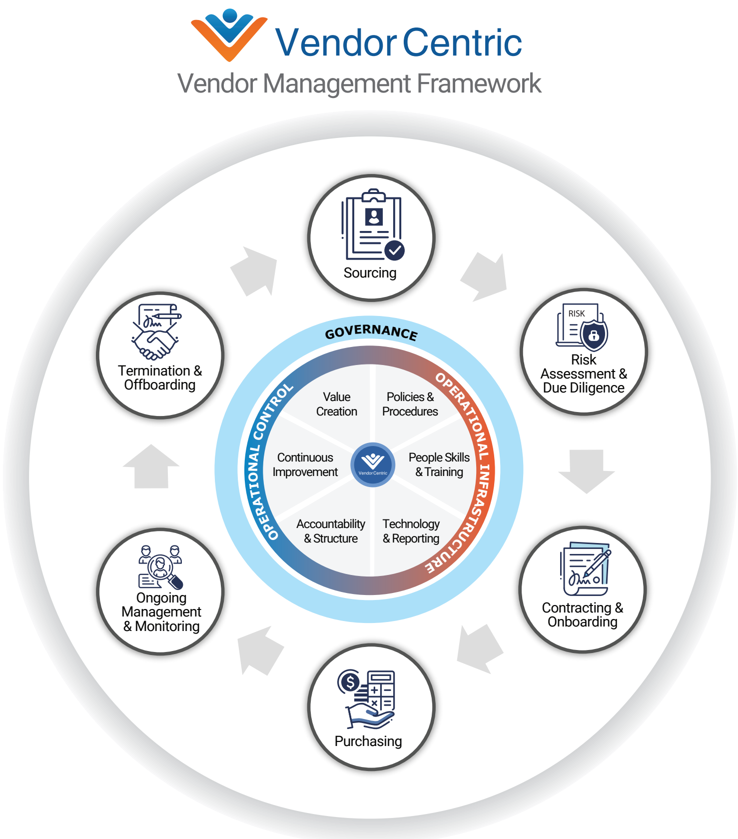
That's why adopting a vendor management framework is so important.

Why You Need a Vendor Management Framework

The term ‘vendor management’ means different things to different people. It can be challenging to discuss vendor management, or operationalize an effective vendor management function, without a standard framework and terminology to set the stage.

This is why a vendor management framework is necessary. It defines the fundamental building blocks of your vendor management function, and provides a reference point to discuss vendor management in a clear, consistent and comprehensive way. It also helps to standardize the ‘language’ of vendor management, which is critical when communicating across different business units and stakeholder groups.

An ideal vendor management framework should balance concepts with practicality, and allow for the right-sizing of activities to organizations of all sizes and industries.



Getting this balance right was key when we created our vendor management framework. It provides a comprehensive yet practical foundation for managing vendors and other third parties, and consists of two core components:

Lifecycle Management: Vendor relationships need to be managed from beginning to end. Our framework ensures the right activities and controls are in place to manage vendors at each stage of the relationship.

Vendor Management Governance: An effective vendor management function requires putting the right people, processes, and systems in place to make it all work. Our framework defines the operational infrastructure and control you need to create and mature a program, and maintain consistency throughout your operations.

Let's take a look at both in more detail.

Framework Component #1: Lifecycle Management

Vendors need to be managed at every stage of the relationship. Taking a lifecycle approach enables you to manage performance, costs, risk and compliance from the very beginning (procurement) to the very end (offboarding).

6 Stages of the Vendor Relationship

Sourcing

Identify and select the right vendor(s) to meet corporate sourcing requirements.

Risk Assessment & Due Diligence

Evaluate and mitigate potential risks before entering into a contract.

Contracting & Onboarding

Negotiate high value, low risk contracts and integrate vendors into your operations.

Purchasing

Buy the goods and services you need through efficient purchasing and spend control.

Ongoing Management & Monitoring

Manage vendor performance and compliance, and monitor and mitigate risks.

Termination & Offboarding

Formally end and 'de-risk' the relationship.

There are literally dozens of activities to manage at every stage. Executing them with efficiency, quality and consistency requires the right infrastructure. That's where framework component #2 comes in.

Framework Component #2: Vendor Management Governance

Vendor management requires aligning the right people, processes and systems to ensure activities are managed consistently and compliantly. Getting these six fundamentals in place allows for sound, scalable governance.

- **Policies & Procedures**
  Establishes the overarching rules, guidelines, activities and operational controls for vendor management.

- **People, Skills & Training**
  Ensures the right level of vendor management resources, subject matter expertise and stakeholder knowledge.

- **Technology & Reporting**
  Centralizes data, facilitates workflow, provides reporting and ensures an audit trail of activities.

- **Accountability & Structure**
  Defines the governing body and establishes the control structure to provide oversight and accountability.

- **Continuous Improvement**
  Ensures operations are continuously improved for efficiency and scale, and aligned with changing business priorities and regulations.

- **Value Creation**
  Supports strategic priorities and creates value through cost savings, risk reduction, performance improvement and innovation.

All of these fundamentals need to be in place for vendor management to operate effectively, they also need to be right-sized for your organization. You want to keep things simple – yet scalable – and add complexity as needed.

Nine Building Blocks to Right-Size Vendor Management for You

Right-sizing vendor management for your company allows you to optimize opportunities, minimize risk and comply with a growing list of regulations. Many organizations are still in the early stages; however, boards, customers and regulators are putting on pressure to do more, faster.

Whether you are just getting a program started, or taking your existing program to the next level, here are nine building blocks you should have in place.

1. **Establish a Solid Foundation.** Make sure you have all vendor management framework components in place. Your program won't be on stable ground without *all of them.*

2. **Set the Tone at the Top.** Your board, senior management and relevant committees all play a critical role in ensuring that accountability is embedded into your culture. Make sure their roles are clearly defined, and processes are in place to escalate issues as they arise.

3. **Maintain Current Profiles on Your Vendors.** Identify, categorize and build profiles of your vendors so you have visibility into each vendor relationship, contracts and risks. You can't manage your vendors effectively without visibility.

4. **Document Policies and Procedures.** Vendor management policies and procedures ensure clarity, consistency and transparency. Make sure yours are documented, and review them at least annually to keep them current and user friendly.

5. **Know Your Regulations.** International, federal and state laws are increasing with regard to vendor management. Many of them address data and business resiliency, which has a significant impact on your vendor management activities. Stay abreast of the ever-changing landscape and update your program accordingly.

6. **Utilize Vendor Management Technology.** You can't maintain an effective vendor management function using Excel and a shared drive of documents. You need a core platform to house all of your vendor profiles, contracts and other documents, and to automate processes for risk assessments, due diligence and ongoing monitoring.

7. **Incorporate Continuous Monitoring.** An annual due diligence process is an important part of your program, but it's only at a point in time. Risks change continuously and you need visibility that matches. Incorporate data intelligence tools such as corporate health monitoring, cyber monitoring and sanctions screening into your program.

8. **Focus on the Metrics that Matter.** Reporting can get overwhelming. Focus on the key metrics that show you the health of your portfolio of vendors and your overall vendor management program.

9. **Review Operations Annually.** Vendor management is an ongoing process. Review operations on an annual basis to ensure controls are operating as designed, processes are as streamlined as possible, and best practices are incorporated to keep things fresh and functional to get the most out of your program.

Vendor Management Program Assessment Tool

Whether you're just getting started with vendor management, or taking your existing operations to the next level, this assessment tool, this assessment tool will help you evaluate whether you have the fundamentals in place to ensure yours is on a solid foundation. If you are missing one or more, those are the areas you should focus on first.

YES	NO	
		Do you have an up-to-date vendor management policy that clarifies the overall objectives and scope of the program?
		Have you clarified governance roles and responsibilities for your board, applicable committees and senior management?
		Have you identified your key areas of risk with third parties, and defined your risk appetite?
		Have you established fundamental standards for vendor risk management such as contracting, insurance and minimum cybersecurity requirements?
		Do you maintain a schedule of all applicable third-party regulations that are addressed through your program, and a process for monitoring regulatory changes?
		Do you have an inventory of all vendors, and a process to determine which ones are in-scope versus out-of-scope?
		Do you maintain current profiles of all in-scope vendors that include, among other things, contractual obligations, risk assessments and open remediation items?
		Have you documented procedures for managing your vendors across all stages of the lifecycle – sourcing through offboarding?
		Do you utilize standard forms and tools such as risk assessments and due diligence questionnaires to ensure consistency in your processes and maintain documentation for an audit trail?

YES	NO	
		Do you utilize a vendor management system to maintain your vendor profiles and contracts, and to facilitate risk assessments, due diligence and other activities?
		Do you provide initial and ongoing training to vendor relationship owners and other stakeholders as to their role and responsibilities, and to share new oversight requirements and best practices?
		Do you provide regular reporting of vendor performance and risks to the board and senior management?
		Do you review the operations at least annually to incorporate continuous improvements and ensure it is operating as designed and meets regulatory requirements?

About Vendor Centric

As pioneers in vendor management since 2011, we've been writing the playbook on how organizations need to rethink vendor relationships and approach vendor management in a holistic way.

We've helped companies large and small, across a variety of industries, reshape vendor management from a piecemealed, siloed set of activities into a coordinated, strategic business function that creates measurable value.

At Vendor Centric, our goal is to help more businesses like yours transform the way you do business by experiencing the power of strategic vendor management.

Visit our website to learn more, or contact us to set up a free consultation.

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